Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of		
Connect America Fund	)	WC Docket No. 10-90
A National Broadband Plan for Our Future	)	GN Docket No. 09-51
Establishing Just and Reasonable Rates for Local Exchange Carriers	)	WC Docket No. 07-135
High-Cost Universal Service Support	)	WC Docket No. 05-337
Developing an Unified Intercarrier Compensation Regime	)	CC Docket No. 01-92
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
Lifeline and Link-Up	)	WC Docket No. 03-109
Universal Service Reform – Mobility Fund	)	WT Docket No. 10-208

REPLY COMMENTS OF THE AD HOC TELECOMMUNICATIONS USERS COMMITTEE

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Filed August 26, 2013

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REPLY COMMENTS OF
THE AD HOC TELECOMMUNICATIONS USERS COMMITTEE

The Ad Hoc Telecommunications Users Committee ("Ad Hoc") hereby submits these Reply Comments in response to the Commission's request for comments[1] on the Report of the Wireline Competition Bureau, recommending a reduction in the authorized rate of return from

[1] *Connect America Fund*, WC Docket No. 10-90, *A National Broadband Plan for Our Future*, GN Docket No. 09-51, *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, *High-Cost Universal Service Support*, WC Docket No. 05-337, *Developing an Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Lifeline and Link-Up*, WC Docket No. 03-109, *Universal Service – Mobility Fund*, WT Docket No. 10-208, Wireline Competition Bureau Seeks Comment On Rate Of Return Represcription Staff Report, 28 FCC Rcd 7120 (2013) ("Public Notice").

11.25% (set in 1990) to a new rate somewhere in the range of 8.06%-8.72%.[2] In 2011, the Commission tentatively concluded that, "[t]he current rate of return . . . is no longer consistent with the Act and today's financial conditions." [3] Ad Hoc agrees.[4] The Staff Report proposes a long overdue and empirically justifiable reduction to the authorized rate of return. The comments filed by parties disputing and disparaging the analysis of the WCB and the Staff Report's proposed reduction to the authorized rate of return have failed to provide useful evidence or economic justification for opposing the Staff Report's recommendations. Indeed, any further delay by the commission in adopting the Staff Report's recommended reduction in the authorized rate of return simply extends the period during which excessively high rates of return remain in place.

A. The Commission should reduce the excessively high authorized rate of return now based upon updated inputs to the current methodology rather than maintain an excessively high rate of return pending the possible adoption of a new methodology at some unspecified future date.

NECA et al. criticize the Staff Report for utilizing the rate of return methodology currently specified in Part 65 by citing earlier statements by the Commission of its intent to update the methodology. NECA thus seeks to dissuade the Commission from re-prescribing the rate of return before revising its Part 65 rules to adopt such a new or updated methodology.[5]

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[2] *Connect America Fund*, WC Docket No. 10-90, Prescribing The Authorized Rate Of Return, Analysis Of Methods For Establishing Just And Reasonable Rates For Local Exchange Carriers, Wireline Competition Bureau Staff Report, 28 FCC Rcd 7123 (2013) ("Staff Report").

[3] *Connect America Fund*, WC Docket No. 10-90, *A National Broadband Plan for Our Future*, GN Docket No. 09-51, *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, *High-Cost Universal Service Support*, WC Docket No. 05-337, *Developing an Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Lifeline and Link-Up*, WC Docket No. 03-109, *Universal Service – Mobility Fund*, WT Docket No. 10-208, Report and Order and Further Notice of Proposed Rulemaking, 26 FCC Rcd 17663, ¶638 (2011) ("R&O & FNPRM").

[4] Comments of the Ad Hoc Telecommunications Users Committee on the R&O & FNPRM, WC Docket No. 10-90 et al. (filed Jan. 18, 2012) ("Ad Hoc 2012 Comments").

[5] Comments of the National Exchange Carrier Association, Inc., NTCA - The Rural Broadband Association; USTelecom; Eastern Rural Telecom Association; and Western Telecommunications Alliance on the Public Notice, WC Docket No. 10-90 et al. at 34-38 (filed July 25, 2013) ("NECA Comments").

Ad Hoc strongly disagrees that the Commission must wait to reduce the current authorized rate of return based upon use of updated inputs until a new methodology is considered and possibly adopted by the Commission at some unspecified date in the future. The statements of the FCC cited by NECA were made back in 2001 as part of an Order that clearly contemplated consideration of a new methodology in the near term.[6] For whatever reasons, the Commission did not, however, act on its intention to adopt a new methodology. Regardless of the merits of any concerns with the Part 65 methodology that existed in 2001, the Commission faces a very real problem with the authorized rate of return today. It makes far more sense to update the rate of return using current inputs rather than continue to use an excessively high return level generated by inputs that are over a decade old and bear no relation to current economic reality.[7]

Ad Hoc is not aware of any effort by NECA over the last decade to promote the adoption of a new methodology. Should the Commission, however, choose to undertake a more extensive review of the current methodology as now suggested by NECA and possibly revise the Part 65 rules as a result of that review, any rate of return level adopted at this time based upon the recommendations of the Staff Report and current data could easily be revised, if necessary, using whatever new methodology the Commission adopts.

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[6] *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers,* CC Docket No. 00-256*, Federal-State Joint Board on Universal Service,* CC Docket No. 96-45*, Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate of Return Regulation,* CC Docket No. 98-77*, Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers,* CC Docket No. 98-166*, Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256,* Fifteenth Report and Order in CC Docket No. 96-45, and Report and Order in CC Docket Nos. 98-77 and 98-166*,* 16 FCC Rcd 19613 (2001) ("MAG Order").

[7] It could be contended that the original call for comments on current methods and inputs to the developing WACC and rate of return in the *R&O & FNPRM* represent the aforementioned "review" of the Part 65 rules.

B. No commenters have justified the use of the FCF WACC calculation methodology that was rejected in the Staff Report.

The Commission can dismiss NECA's recommendation that the WACC should be calculated using the Free Cash Flow ("FCF") methodology[8] rather than developing a Weighted Average Cost of Capital ("WACC") using either the Discounted Cash Flow ("DCF") or Capital Asset Pricing Model ("CAPM") consistent with the existing Part 65 rules. Contrary to its claims, NECA has failed to correct the significant deficiencies with that approach that caused the WCB to dismiss such recommendation in the Staff Report.[9] Moreover, the WACC calculations performed by the WCB Staff using the DCF and CAPM methodologies are consistent with the existing Part 65 rules and would require no rule changes; prescription of a rate of return using a WACC range calculated using NECA's proposed FCF would not be consistent with the current rules.[10]

C. WCB Staff's use of proxy ILECs to develop the WACCs reported in the Staff Report is a valid approach to represcribing the rate of return.

Several commenters have criticized the Staff Report for the use of *publicly-traded* rate-of-return incumbent LECs as proxies for rate-of-return incumbent LECs *generally* when calculating the WACC as an input to the recommended range for a rate of return.[11] These

[8] Comments of the National Exchange Carrier Association, Inc.; National Telecommunications Cooperative Association; Organization for the Promotion and Advancement of Small Telecommunications Companies; and the Western Telecommunications Alliance on the R&O & FNPRM, WC Docket No. 10-90 et al. (filed Jan. 18, 2012) ("NECA 2012 Comments").

[9] Declaration of Susan M. Gately attached hereto as Appendix A at 2-5 ("Gately Declaration").

[10] Gately Declaration at 5-6.

[11] *See, e.g.*, Comments of the ICORE Companies on the Public Notice, WC Docket No. 10-90 et al. (filed July 24, 2013) at 5-7 ("ICORE Comments"); comments of the Alaska Rural Coalition on the Public Notice, WC Docket No. 10-90 et al. (filed July 25, 2013) at 9 ("Alaska Rural Coalition Comments"); comments of the Rural Telephone Finance Cooperative on the Public Notice, WC Docket No. 10-90 et al. (filed July 24, 2013) at 2, 6-7; NECA Comments at 20-25, 28-30 and Appendix A, Professor Randall Billingsley Statement: In Re: Wireline Competition Bureau Rate of Return, Represcription Staff Report, DA 13-1110, May 16, 2013 at 4-13.

critiques focus upon purported differences between the scale of the publicly and privately (or co-operatively) owned RLECs and the diversity of operations of the two groups.

These criticisms, however, are flawed. NECA is wrong when it claims it is "highly noteworthy, for example, that the WACC estimates for RLECs produced under the Bureau's methods are lower than estimates produced for the regional Bell Holding Companies (RHCs)."[12] It is also wrong with regard to its recommendation for the addition of a significant "risk premium" based upon the size of the company.[13] NECA's positions (and those expressed by Professor Billingsley in Appendix A to NECA's Comments) are premised upon analysis of publicly-traded stock transactions across the US economy – ignoring the fundamental differences between the market and regulatory constructs in which the publicly traded firms operate and the conditions in which RLECs operate.[14]

Although the RHC's and mid-sized price cap LECs that are part of the sample are characterized as offering a more diverse range of services than the RLECs that are not part of the proxy group,[15] neither the presumption that RLECs necessarily have a less diverse range of product offerings nor the conclusion drawn from that presumption (that RLECs with less diverse operations face a higher cost of capital) is necessarily, or even likely, to be true.[16] The commenters base their argument on pure speculation, and no evidence has been provided in support of either contention. Thus, the Commission should give no consideration to such claims andneed not accommodate to the baseless demands for collection of additional data and further delay in re-prescription of the rate of return.

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[12] NECA Comments at 4.

[13] NECA Comments at 28.

[14] Gately Declaration at 6-8.

[15] *See, e.g.,* ICORE Comments at 5-7.

[16] Gately Declaration at 8-9.

D. Reduction in the rate of return will not hamper broadband investment by small RLECs.

Commenters claim that a reduction in the level of the authorized interstate rate of return from the current 11.25% will dis-incent small RLECs from investing in broadband and directly contravene the Commission's ongoing efforts to have broadband deployed to those rural customers that do not have broadband service today.[17] These arguments are flawed for two reasons.

First, most of the small LECs that purportedly will be dis-incented to deploy broadband have *already* deployed broadband in their networks. The Commission should not confuse the approximately 2% of access lines nationwide that are provided by ICOs with the 2% of households nationwide that do not have broadband service available. As the Commission's own reporting demonstrates, the lion's share of households without broadband service do not fall within ICO territories but rather in exchange areas presently or formerly operated by the RHCs.[18]

Second, although ostensibly presented as arguments against the specific rate of return recommended by the Staff Report, in fact, the commenters' arguments disfavor any reduction in the overall authorized return levels or guaranteed revenue. The argument they make is tautological: a higher return will make it easier to raise capital and will stimulate investment – regardless of whether that return is too high, too low, or just right.

These arguments would be the same if you substituted a reduction in the rate of return from 40% to 35% (even for those RLECs that have yet to deploy to broadband). Yet no one would recommend purposely setting a rate of return that is known to be too high. And even if it were appropriate for the Commission to utilize a higher-than-necessary rate of return to incent

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[17] ICORE Comments at 5-6; Alaska Rural Coalition Comments at 1, 5.

[18] Gately Declaration at 10.

ICO RLECs to deploy additional broadband services, it is not necessary to do so since the Commission has a more targeted and effective tool to create such incentives through new CAF funding initiatives.

E. The Commission should choose the rate of return from the lower, not the upper, end of the range of WACCs.

NECA argues that to the extent a new rate of return is prescribed, that return level should be taken from the upper end of the range of calculated WACCs.[19] Ad Hoc disagrees. Consistent with and for the reasons enumerated in our January 18, 2012 Comments[20] and the Comments of NASUCA in response to the Public Notice[21], the chosen return level should be taken from the lower end of the range of WACCs. The Declaration of Susan M. Gately, attached hereto as Appendix A, describes the special conditions in which the ICO RLECs operate that reduces the overall level of risk associated with their operations vis-à-vis the carriers in the Staff proxy group used to calculate the range of WACCs.

Additionally, Ad Hoc reiterates its earlier position that the dangers inherent in prescribing a return that is too high far outweigh the dangers inherent in prescribing a rate that is too low.[22]

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[19] NECA Comments at 9. This is precisely what the WCB Staff recommends in the Staff Report. NECA, however, is arguing for the use of a result from the much higher range of WACCs calculated using its proposed change to the WACC formulation from that specified in Part 65 of the Commission's rules to one based upon the FCF methodology dismissed by the WCB Staff in its report.

[20] Ad Hoc 2012 Comments at 15.

[21] Comments of the National Association of State Utility Consumer Advocates ("NASUCA"), WC Docket No. 10-90 et al. (filed July 24, 2013).

[22] Ad Hoc 2012 Comments at 8-11.

Conclusion

Based on the foregoing and the current record in this proceeding, Ad Hoc urges the Commission to set the interstate rate of return at a level from the lower end of the range of the WACC presented in the Staff Report. Further proceedings on this issue are not necessary and would serve no purpose other than to delay correction of the currently excessive rate of return.

Respectfully submitted,

AD HOC TELECOMMUNICATIONS
USERS COMMITTEE

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Appendix A

Declaration of Susan M. Gately

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Declaration of

Susan M. Gately

On Behalf Of
Ad Hoc Telecommunications Users Committee

August 26, 2013

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DECLARATION OF SUSAN M. GATELY

INTRODUCTION

Susan M. Gately, of lawful age, declares and says as follows:

1. My name is Susan M. Gately; I am President of SMGately Consulting, LLC (SMGC), 84 Littles Avenue, Pembroke, MA 02359. SMGC is a consulting firm specializing in telecommunications and public policy. I have participated in numerous proceedings before the Federal Communications Commission ("FCC" or "Commission") dating back to 1981 and have appeared as an expert witness in state proceedings before state public utility commissions. My Statement of Qualifications is annexed hereto as Attachment 1 and is made a part hereof.

2. I was asked by the Ad Hoc Telecommunications Users Committee to undertake research in support of Reply Comments that will be filed on the Committee's behalf on August

26, 2013. This declaration sets forth the results of that research and analysis and provides the supporting documentation for many of the facts and figures cited in those Reply Comments.

THE PROPOSED "FREE CASH FLOW" METHOD WILL NOT YIELD AN ACCURATE WACC FOR FCC PURPOSES

3. NECA et al propose use of a Free Cash Flow (FCF) method of determining the Weighted Average Cost of Capital (WACC) as an alternative to the WACC methodology formulated in 47 CFR Parts 65.300 through 65.301. NECA claims that "The FCF approach is well accepted by financial analysts and is described in standard textbooks"[1] (NECA et al Appendix B at 3). While true that FCF is used by financial analysts - it is not used as a tool to estimate a firm's WACC – but rather the value of a firm. NECA's use here is novel – not standard – which is why it is necessary in Appendix B for NECA to describe how a formula that is sometimes used to estimate value has been translated into a formula that estimates a WACC. (NECA et al Appendix B at 3).

4. NECA's novel formulation offers the FCC no useful information at all. In a claim based entirely upon speculation it reports that the price per line (value) of RLECs has fallen and can be expected to continue to fall, and that "cost of capital estimates using the FCF method increase as per-line prices decrease." What NECA does not point out is that performing the very same exercise using its FCF method a reduction in a firm's free cash flow results in a reduction in the WACC – a result that is completely counter-intuitive and counter to the way the real world works. In the real world a firm with less free cash flow, all else being equal, would likely face higher costs in the capital market than a firm with more free cash flow. The example

[1] NECA Comments, Appendix B at 5 -6

below demonstrates the fallacy of NECA's proposed approach. Appendix B of NECA's Comments reports its FCF WACC formula as follows:

$$WACC = FCF/Value.$$ (NECA Appendix B at p.3).

It also reports that using the weighted median FCF amount from its January 2012 filing, and assuming a price per line (*Value*) of $2400, the resulting *WACC* would be 11.75% which means that the weighted median FCF used in that analysis was $282:

$$WACC(11.75\%) = FCF(\$282)/Value(\$2400)$$

Translated this says that a firm with an FCF of $282 and a value of $2400 would have a cost of capital of 11.75%. The flaw in NECA's analysis becomes clear when you assume that the level of free cash flow generated by the firm is reduced – because rather than increase the return required to make capital available, the formula yields a lower cost of capital. If the FCF of the firm were 50% less – in this case $141 – NECA's FCF WACC estimation model would yield a WACC 50% less – in this case – 5.88% as seen in the equation below: :

$$WACC(5.88\%) = FCF(\$141)/Value(\$2400)$$

NECA'S PURPORTED CORRECTIONS TO THE RURAL ALLIANCE'S FREE CASH FLOW METHOD OF CALCULATING A WACC CONTINUES TO BE FLAWED

5. In dismissing the NECA's FCF methodology, the Staff Report criticized NECA's use of the median FCF value from the sample of RLEC data (used in NECA's January 2012 WACC

estimation) rather than the use of the mean FCF level.[2] In its Comments on the *Staff Report* NECA presented revised (and significantly lower) WACC results based upon use of a weighted mean.[3] The weighted median result that NECA presented in its January 2011 result was 35% higher than revised result contained in its Comments here – giving credence to Staff's belief that the mean would yield significantly different results. In proffering its revised results NECA offers no explanation for the use of a weighted mean rather than the actual mean identified as appropriate in the *Staff Report*. Given the vast difference between the weighted median and mean, it is likely that the actual mean is yet lower than the weighted mean. If true, this would mean that even using NECA's odd FCF WACC estimation model the resulting WACCs would likely be yet lower, perhaps substantially lower, than those reported in NECA's initial Comments here. Since each RLEC operates independently of the others weighting the mean by access lines in this case skews the value and detracts from the overall validity (to the extent there is any) of the entire exercise.

6. NECA also purports to address Staff's concerns regarding artificially low Value estimates (per line sale prices) used in its earlier analysis – but fails to provide updated results or to produce any additional supporting data.[4] Attached to the Appendix as support for its per line sale analysis is a four page listing of ILEC property transactions from 1999 – 2012 – the vast majority of which contain "na" designations for every data point. So, for example, for the most recent period, the years 2010, 2011 and 2012, Attachment A to Appendix B contains 26 separate lines purportedly detailing ILEC property transactions that took place during that period – but

[2] *Staff Report* at fn 94
[3] NECA Comments at 5
[4] NECA Appendix B at pp 5 – 6

sales price information and other financial data are available for only 3 of those transactions (transactions where at least one of the parties was publicly-traded). The only thing added to NECA's response to Staff criticism is additional rhetoric and suppositions.

7. NECA itself stated in its Jan 2012 Comments that: "RLEC lines may be more valuable than price cap companies' rural lines for at least two reasons. First, RLEC lines are in better shape because these companies have heretofore focused their full attention, investment and maintenance upon their rural exchanges."[5]

8. Nor does NECA's response to Staff's criticism of the non-random basis of its sample change the fundamental problems with the data. NECA responds that contrary to Staff's characterizations, the data set included average schedule companies as well as cost companies, and that when analyzed in terms of line size the NECA sample compared favorably to the NECA common line pool participants.[6] If the analysis being undertaken was predicated in any manner on RLEC line counts then the fact that the two data sets had similar distributions would have some import. Here, where the data being used is financial – an analysis of the level of free cash flow – the similar line size distributions are of no matter.

USE OF THE FCF METHOD OF CALCULATING A WACC WOULD BE INCONSISTENT WITH CURRENT PART 65 RULES

9. In addition to the problems highlighted with NECA's proposed FCF method of WACC estimation is the fact that use of that methodology would require a rewrite of 47 CFR

[5] Rural Alliance Jan 2012 Comments at 58
[6] NECA Appendix B at pp 4 – 5

Part 65.301, 302 and 303. The WACC recommendations contained in the Staff Report were developed in compliance with the existing Part 65 methodology and can be implemented by the Commission without undertaking a lengthy rule change proceeding. Conversely, adoption of NECA's proposal would require a rule change. Parts 65.301 – 303 specify three separate and additive components that are be used to develop the WACC (cost of debt, cost of equity and cost of preferred stock). NECA's alternative methodology replaces those three measurements with a unitary result based upon it novel FCF formulation – in NECA's own words "The FCF approach, therefore, avoids having to deal with separate errors of estimating the cost of debt and equity as well as the target capital structure weights."

DESPITE CLAIMS, NO EVIDENCE HAS BEEN PROFFERED THAT SMALL RLECS EXHIBIT MORE RISK THAN LARGER ILECS

10. Claims that the use of use of publicly-traded incumbent LECs as proxies for rate-of-return incumbent LECs generally in the calculation of the WACC fails to account for the increased risk (and correspondingly higher cost of capital) of the smaller firms that make up the pool of rate of return RLECs are wrong. Citing general economic theory and financial literature (like Ibbotson) demonstrating an inverse relationship between size and risk in publicly traded companies across the economy, NECA et al fail to acknowledge that rate of return RLECs do not operate in the same environment, or subject to the same market rules as other firms across the US economy.[7]

[7] (See, for example, NECA et al Comments at 2, 30 and Appendix A, Billingsley Statement at 4 – 13

11. Even ignoring for a moment the existence of universal service distributions that ultimately flow to the RLECs bottom lines and that are not available to other "small" firms operating in the economy at large, the fact that these carriers prices are targeted to achieve a specific rate of return, and reset annually to ensure that the authorized level of return is met, substantially alters the risk environment and makes scale much less relevant than in non-regulated scenarios. When the virtual guarantee of universal service disbursements (existing HCF funds and new CAF funds, including CAF funding for ICC reform shortfalls) are added into the analysis it becomes clear that there is no reason to expect the level of "risk" attendant to small RLEC investments to be greater than that of larger ILECs (who are not subject to the same guarantees and for whom USF disbursements make up a much smaller portion of the total revenue stream) or of other small firms operating in the economy.

12. Those criticizing the *Staff Report* for using publicly traded firms as proxies also fail to provide any actual evidence of higher risk premiums being required of smaller rate of return RLECs than the of larger publicly-traded ILECs (such as higher cost of debt). Nor have they (or could they) demonstrate that the cost of equity for the small privately held rate of return RLECs is greater than for the larger carriers because these privately held companies don't go to the market to raise capital. Interestingly, the only evidence that is in the record regarding the relationship between size and the cost of equity demonstrates that the cost of equity for the publicly traded mid-sized ILECs and RLECs is lower, not higher, than for the much larger RHCs.

13. NECA's comparison of the level of risk associated with an RLEC serving 6000 lines and a food truck parked on the corner of 13th and K Streets (NECA et al Comments at footnote 32) is nonsensical. It would be relevant only if the food truck were the only provider that could provide lunch to workers in that area, the FCC had the food truck operator charge those workers prices designed to yield an adequate level of return, subsidized the food truck for any menu items that were particularly expensive to provide and RUS loaned the food truck owner the funds to purchase the truck at below-market interest levels.

MANY RLECS HAVE A DIVERSE RANGE OF PRODUCT OFFERINGS

14. Parties criticizing the FCC's use of publicly traded ILECs (only some of whom are rate of return carriers) as proxy's for rate of return ILECs generally also claim that the RHCs offer a more diverse range of product offerings than the RLECs, drawing the conclusion that RLECs with less diverse operations face a higher cost of capital. These claims and conclusions are wrong.

15. First, while there may in fact be some RLECs that are stand-alone companies offering only traditional voice wireline service to a single small exchange area or two that is most frequently not the case. Most, if not all RLECs today have deployed some measure of broadband services to a portion, if not all, of their subscribers. Many are owned by holding companies that operate several individual operating companies across multiple states. Many are owned by, or own themselves, affiliates in addition to the original wireline franchise that operate as wireless carriers, CLECs in other exchange areas, internet access service providers and cable

TV operators. While less geographically diverse than their larger RHC breather, the portrayal of these firms as single service providers offering only traditional wireline services with revenue streams entirely subject to the upheaval of the ongoing USF / ICC transformation is misleading. In fact, in describing its 900 RLEC members in NECA et al's Comments in this proceeding, NTCA (one of the parties sponsoring the Comments) stated "*All of NTCA's members* are full service local exchange carriers (LECs) *and broadband providers*, and *many of its members provide wireless, cable, satellite, and long distance and other competitive services to their communities.*"[8] As the example below illustrates, even the smallest of RLECs operating in the some of the most remote territories of the US exhibit this diversity of operations. The Adak Telephone Utility operating in Adak Alaska, the westernmost point in the entire US, is owned by Adak Eagle Enterprises which is also the owner of Windy City Cellular (serving Adak and surrounding areas), Windy City Broadband and Adak Cablevision. Their website proclaims 'Whether you need to make a call using a home phone or cellular device, want access to the internet, or want to watch your favorite TV shows, we have what you need. Call us today!" [9]

16. To the extent that some RLECs operations are limited to traditional wireline voice services there is no evidence that the result is a requirement for a higher cost of capital. As with the discussion in paragraphs 12 to 14 above there is every reason to believe (and no evidence to refute) that the risk profile of these carriers is lower than for the purportedly more diverse, and unquestionably larger, RHCs for whom the relatively risk-free USF disbursements and rates subject to RoR are a less significant portion of total revenues.

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[8] NECA et al Comments at footnote 2, emphasis added.
[99] Adak Telephone website. http://www.adaktu.net

CLAIMS THAT A REDUCTION TO THE AUTHORIZED RATE OF RETURN WILL HAMPER BROADBAND DEPLOYMENT ARE LITTLE MORE THAN SCARE TACTICS

17. Almost a decade ago the FCC gave carriers, including RLECs, carte blanche to deploy broadband services to their subscribers, classify the investment as regulated basic exchange plant, and recoup that expense as part of their universal service disbursements.[10] Most of the small RLECs took advantage of that opportunity and in fact deployed broadband services across their networks. None-the-less, several commenters have claimed that a reduction in the authorized rate of return will dis-incent these very same RLECs from deploying broadband thereby stymieing the Commissions goals for ubiquitous broadband deployment.

18. Recent Commission reporting identifies approximately 15-million households across the country to who broadband has not been deployed.[11] Many, perhaps the vast majority, of those households are located in RHC, not RLEC, service territories. For example, AT&T has reported that broadband service has not been deployed to 25% of its customer locations.[12]

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[10] In its *Broadband Wireline Internet Access ("BWIA") Order*, the FCC specifically directed the RBOCs not to assign or allocate costs associated with new broadband services – services that were deregulated by the BWIA Order itself – to the nonregulated category in ARMIS. *In the Matter of Appropriate Framework for Broadband Access to the Internet over Wireline Facilities; Universal Service Obligations of Broadband Providers; Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services; Computer III Further Remand Proceedings: Bell Operating Company Provision of Enhanced Services; 1998 Biennial Regulatory Review – Review of Computer III and ONA Safeguards and Requirements; Conditional Petition of the Verizon Telephone Companies for Forbearance Under 47 U.S.C. § 160©) with Regard to Broadband Services Provided Via Fiber to the Premises; Petition of the Verizon Telephone Companies for Declaratory Ruling or, Alternatively, for Interim Waiver with Regard to Broadband Services Provided Via Fiber to the Premises; Consumer Protection in the Broadband Era*, CC Docket No. 02-33; CC Docket No. 01-337; CC Docket Nos. 95-20, 98-10; WC Docket No. 04-242; WC Docket No. 05-271, 20 FCC Rcd 14853, 14863-5 and 14926. (2005).

[11] FCC News Release dated August 21, 2013: *Connect America Fund Expands Broadband to Up to 600K Homes, Businesses.* Accessed at http://transition.fcc.gov/Daily_Releases/Daily_Business/2013/db0821/DOC-322945A1.pdf

[12] AT&T Press Release, 11/7/12 *AT&T to Invest $14 Billion to Significantly Expand Wireless and Wireline Broadband Networks.* http://www.att.com/gen/press-room?pid=23506&cdvn=news&newsarticleid=35661

Verification

The foregoing statements are true and correct to the best of my knowledge, information and belief.

Susan M Gately

Susan M. Gately
Statement of Qualifications

Susan M. Gately founded SMGately Consulting, LLC (SMGC) in January of 2011. Susan is an economic and policy expert specializing in the telecom arena with more than thirty years of consulting experience. Her specific experience lies in the areas of

- Telecom industry structure;
- Regulatory regimes;
- Cost development;
- Access charges;
- Pricing and rate structure; and
- Telecom services and network management practices.

Prior to founding SMGC Susan was a partner in and the Senior Vice President at Economics and Technology, Inc (ETI) providing advising, litigation support, expert testimony, white papers, and in-house training and education to ETI's myriad carrier, governmental agency and large business clients. Susan has provided expert testimony on a variety of telecom policy matters and participated in hundreds of FCC proceeding on access charges, universal service, separations and cost accounting, and form of regulation.

Throughout 2011 Ms. Gately was an active participant in the FCC's USF / ICC proceeding on behalf of the AdHoc Telecommunications Users Committee preparing and submitting two separate declarations and visiting the FCC on multiple occasions to discuss the results of her analyses. In particular, Ms. Gately devoted significant effort in the analysis of RLEC cost data filed as part of that proceeding and quantification of the financial impact upon RLECs of the potential combination of reduced USF payments and reduced access charge revenues.

For the last several years Ms. Gately has also been particularly active in the analysis of special access pricing, cost, and separations data. In 2010 she authored a paper entitled *Longstanding Regulatory Tools Confirm BOC Market Power: A Defense of ARMIS*.[1] The paper detailed the workings of and interactions between Parts 36 and 69 of the FCC's rules (the results of which are codified in ARMIS for the largest of the ILECs). Susan has been involved in the analysis of incumbent LEC intrastate and interstate access tariffs since the filing of the initial access tariffs in 1983. Ms. Gately has participated in the preparation of hundreds of submissions to the FCC on issues including access service pricing and rate structures, price caps implementation, access

[1] *Longstanding Regulatory Tools Confirm BOC Market Power: A Defense of ARMIS* (With Helen E. Golding, Lee L. Selwyn and Colin B. Weir. Released in January, 2010.) Prepared on behalf of the AdHoc Telecommunications Users Committee. Filed in FCC WC Docket # 05-25 January, 2010.

service costs (including cost allocation of regulated and non-regulated services), and alternative forms of regulation.

Ms. Gately has also devoted significant time over the last several years to researching and analyzing conditions extent in the wireline and wireless telecommunications markets in the US, the conditions that have led to the current market structures and the implications for users of those networks. In addition to the *ARMIS* paper identified above Ms. Gately's research and analysis in this area where codified in the following papers released in 2010. *Regulation, Investment and Jobs: How Regulation of Wholesale Markets Can Stimulate Private Sector Broadband Investment and Create Jobs* (With Helen E. Golding, Lee L. Selwyn and Colin B. Weir. Released in February, 2010.) *Revisiting US Broadband Policy: How Reregulation of Wholesale Services Will Encourage Investment and Stimulate Competition and Innovation in Enterprise Broadband Markets* (With Helen E. Golding, Lee L. Selwyn and Colin B. Weir. Released in February, 2010.)

Ms. Gately's most recent analysis of small independent company universal service issues in relation to the FCC's 2011 USF / ICC proceeding built upon her extensive past analysis of similar issues (as they relate to both state and interstate universal service funds). Beginning in 2003 and following on for the next several years she researched and documented systemic incentives to inefficiencies inherent in the FCC's USF funding mechanism and identified . The primary documentation of that early work was a paper entitled *Lost in Translation: How Rate of Return Regulation Transformed the Universal Service Fund for Consumers into Corporate Welfare for the RLECs*, (with Scott C. Lundquist) prepared on behalf of Western Wireless, February 2004. That work was followed later that same year with *Striking a Nerve: ETI's Rejoinder to the NTCA/OPASTCO False Premises Report*, (with Lee L. Selwyn and Scott C. Lundquist) also prepared on behalf of Western Wireless, October 2004. Ms. Gately has prepared presentations for on this issue for use at en banc panels of the Federal State Board on Universal Service and presented a session at NASUCA's 2005 annual conference as well.

Susan has been involved in the analysis of incumbent LEC intrastate and interstate access tariffs since the inception of the tariffs in 1984. She has participated in virtually every major FCC proceeding on access charges and price caps, and is among the nation's leading experts on access charge rate structure, methodology, and policy. Access issues addressed in the hundreds of submissions made to the FCC access service pricing and rate structures, price caps implementation, access service costs (including cost allocation of regulated and non-regulated services), and alternative forms of regulation. Among those issues recently addressed at the FCC has been the appropriate rate structure for the collection of universal service costs from end users, and rules related to the level of universal service funding that should be available to rural telecommunications service providers. Ms. Gately was also actively involved in the investigation of the level of cost to be recovered from the implementation of local number portability (LNP) and the appropriate method of recovering those costs. Ms. Gately was also involved in modeling and analysis of the FCC's last major revision to its access charge and price caps plan — the so called "CALLS" plan.

Ms. Gately has also been extensively involved in the analysis of cost and operational data submitted by telephone companies in the context of regulatory proceedings and audits, including the submission of expert testimony in state public utility proceedings. Her responsibilities have involved the analysis of telephone company cost data and cost study methodologies. Ms. Gately's work has included the development of alternative cost figures for the purpose of presenting alternative rate proposals. She has participated in the preparation of expert testimony on local calling area expansion, affiliate transactions, survey and statistical methodologies, cost study methodologies, revenue requirement, infrastructure and modernization, new service pricing, access pricing, unbundled network element pricing, avoided retail costs for use in setting wholesale prices and other issues related to the opening and operation of markets.

Throughout 1994, acting as a staff expert for the Delaware PSC Staff, Ms. Gately participated actively in the litigation of rules implementing an alternative regulatory plan put in place by the Delaware state legislature. Ms. Gately was one of the designated staff negotiators during an attempted negotiated settlement of the rules using Alternate Dispute Resolution (ADD) techniques. Subjects addressed by the PSC's Rulemaking included, among other things, the development of both incremental and fully distributed costing methodologies to be used by Bell Atlantic for use as incremental cost floors, and to ensure against cross-subsidization. She co-authored comments on behalf of staff regarding cost methodology, rate imputation, and unbundling requirements.

Ms. Gately was particularly active in the examination of ILEC cost data and deployment plans for basic rate interface (BRI) ISDN service. Ms. Gately was involved in all facets of a New England Telephone BRI ISDN investigation that culminated in an affordable, widely deployed ISDN offering in Massachusetts. She has also prepared and/or sponsored testimony and comments relative to the deployment and pricing of ISDN services in Colorado, Tennessee, Texas, Ohio, and Connecticut. Ms. Gately also co-authored two separate ISDN position papers in conjunction with Dr. Lee L. Selwyn; *A Migration Plan for Residential ISDN* for the Electronic Frontier Foundation and *The Prodigy ISDN White Paper: ISDN Has Come of Age* for Prodigy Services Company.

Ms. Gately was also heavily involved in the development of avoided cost estimates for use in setting wholesale prices in a resale environment. Ms. Gately co-authored (with Dr. Lee L. Selwyn) *Commercially Feasible Resale of Local Telecommunications Services: An Essential Step in the Transition to Effective Local Competition*. She has participated in resale proceedings and or interconnection arbitrations (relative to wholesale pricing) in California, Hawaii, Illinois, Ohio, Puerto Rico, Nevada, and Louisiana.

Ms. Gately was also involved in the analysis of issues related to the application of several of the Bell Companies for Section 271 authority to enter the interLATA long distance market. Ms. Gately has also undertaken a detailed analysis of the Continuing Property Record (CPR) audits conducted by the Accounting and Audits Division of the FCC. That analysis culminated in the preparation of a paper (written in conjunction with Dr. Lee L. Selwyn) *Inflated BOC Prices: An Agenda for State PUC Actions Arising from the FCC CPR Audits.*

Ms. Gately has assisted numerous Fortune 100 companies in the evaluation of pricing, terms and conditions as part of the long distance and local procurement process.

In addition to her regulatory work, Ms. Gately has been a frequent speaker at various industry gatherings including large conventions and more specialized seminars and conferences. The subject matters have included the following wide range of issues:

- Negotiation of custom network contracts;
- ILEC central office collocation;
- The FCC's price cap plan for ILECs;
- Principles for pricing ISDN basic rate service.
- USF Funding for wireless CETCs
- Reformation of the USF High Cost Fund

Prior to joining ETI, Ms. Gately was employed as an Economic Analyst at Systems Architects, Inc. Her work there primarily involved the analysis of economic data and survey results for the Health Care Finance Administration, the Social Security Administration, and the Department of Defense.

Susan has a Bachelor of Arts degree in Economics from Smith College (1980).

Appearances in Regulatory Proceedings

Telecommunications Regulatory Board of Puerto Rico, *Telefónica Larga Distancia de Puerto Rico, Inc., Petition for arbitration pursuant to Section 47 U.S.C. 252 (b) of the Federal Communications Act and Section 5 (b), Chapter III, of the Puerto Rico Telecommunications Act, regarding interconnection rates, terms and conditions with Puerto Rico Telephone Company, Inc.*, Docket No. JRT-2006-AR-0001, on behalf of Telefónica Larga Distancia de Puerto Rico, Inc., Direct Testimony filed January 16, 2007, Reply Testimony filed February 7, 2007, cross-examination February 14, 2007, Declaration filed March 30, 2007.

United States District Court, District of New Jersey, in *Re: AT&T Corp. v. JM Telecom, LLC*, Civil Action No. 99-2578, on behalf of AT&T Corp., Expert Report filed December 5, 2003.

California Public Utilities Commission, in *Re: Order Instituting Rulemaking to Review Policies Concerning Intrastate Carrier Access Charges*, Docket No. R.03-08-018, on behalf of AT&T Communications of California, Inc. Declaration filed November 12, 2003.

Colorado Public Utilities Commission, in *Re: Application of US West Communications, Inc. for Investigation into Switched Access Rates,* Docket No. 00A-201T, on behalf of AT&T Communications of the Mountain States, Inc., Testimony of Lee L. Selwyn, filed July 18, 2000, adopted by Susan M. Gately, cross-examined on October 17, 18, 2000.

Arizona Corporation Commission, in *Re: In the Matter of the Application of US West Communications, Inc., a Colorado Corporation, for a Hearing to Determine the Earnings of the Company, the Fair Value of the Company for Ratemaking Purposes, to Fix a Just and Reasonable Rate of Return Thereon and to Approve Rate Schedules Designed to Develop Such Return*, Docket No. T-1051B-99-105, on behalf of AT&T Communications of the Mountain States, Direct Testimony filed August 9, 2000, Supplemental Direct Testimony filed November 13, 2000.

United States District Court, District of Massachusetts, in *Re: Telephone Management Corporation, Plaintiff, v. State Street Bank and Trust Company, Defendant*, Civil Action No. 97-10993 PBS, on behalf of State Street Bank and Trust Company, Expert Report filed July 17, 1998.

Delaware Public Service Commission, in *Re: In the Matter of Development of Regulations for the Implementation of Telecommunications Technology Investment Act*, Docket No. PSC Reg. 41, on behalf of Delaware Public Service Commission Staff, cross-examination March 2, 1995.

New York Public Service Commission, in *Re: Proceeding on Motion of the Commission to Investigate Performance-Based Incentive Regulatory Plans for New York Telephone Company,* Docket No. 92-C-0665, on behalf of Cable Television Association of New York, Supplemental Testimony filed September 8, 1994.

California State Legislature, in*Re: California Long Distance Telecommunications Consumer Choice Act*, Assembly Bill 3720, on behalf of AT&T, Statement before the California State Legislature, April 11, 1994.

Tennessee Public Service Commission, in*Re: In the Matter of the Commission's Investigation of Integrated Services Digital Network (ISDN)*, on behalf of Prodigy Services Company, oral testimony, November 11, 1992.

Arizona Corporation Commission, in *Re: In the Matter of the Commission's Examination of the Rates and Charges of the Mountain States Telephone and Telegraph Company* , Docket No. E-1051-88-306, on behalf of Residential Utility Consumer Office, Direct Testimony filed July 13, 1990, Rebuttal Testimony August 7, 1990.

Papers and Reports

The Benefits of a Competitive Business Broadband Market (With Helen E. Golding. Released April, 2013)

Regulation, Investment and Jobs: How Regulation of Wholesale Markets Can Stimulate Private Sector Broadband Investment and Create Jobs (With Helen E. Golding, Lee L. Selwyn and Colin B. Weir. Released in February, 2010.)

Revisiting US Broadband Policy: How Reregulation of Wholesale Services Will Encourage Investment and Stimulate Competition and Innovation in Enterprise Broadband Markets- (With Helen E. Golding, Lee L. Selwyn and Colin B. Weir. Released in February, 2010.)

Longstanding Regulatory Tools Confirm BOC Market Power: A Defense of ARMIS (With Helen E. Golding, Lee L. Selwyn and Colin B. Weir. Released in January, 2010.)

The Role of Regulation in a Competitive Telecom Environment: How Smart Regulation of Essential Wholesale Facilities Stimulates Investment and Promotes Competition (With Helen E. Golding, Lee L. Selwyn, and Colin B. Weir. Released in March, 2009.)

Special Access Overpricing and the US Economy: How Unchecked RBOC Market Power is Costing US Jobs and Impairing US Competitiveness (with Helen E. Golding, Lee L. Selwyn, and Colin B. Weir) Economics and Technology, Inc., prepared on behalf of the AdHoc Telecommunications Users Committee, August 2007.

HOLD THE PHONE: Debunking the Myth of Intermodal Alternatives for Business Telecom Users In New York, prepared on behalf of the UNE-L CLEC Coalition in New York, August 2005.

The 2005 Update of the 1999 TFP Model Calculating a Productivity Factor for Interstate Special Access, prepared on behalf of the Ad Hoc Telecommunications Users Committee, submitted as an attachment to Susan M. Gately's Reply Declaration, filed in FCC WC Docket No. 05-25, *Special Access Rates for Price Cap Local Exchange Carriers*, July 29, 2005.

Striking a Nerve: ETI's Rejoinder to the NTCA/OPASTCO False Premises Report, (with Lee L. Selwyn and Scott C. Lundquist) prepared on behalf of Western Wireless, October 2004.

Competition in Access Markets: Reality or Illusion, A Proposal for Regulating Uncertain Markets, (with Lee L. Selwyn and Helen E. Golding), prepared on behalf of the Ad Hoc Telecommunications Users Committee, August 2004.

Lost in Translation: How Rate of Return Regulation Transformed the Universal Service Fund for Consumers into Corporate Welfare for the RLECs, (with Scott C. Lundquist) prepared on behalf of Western Wireless, February 2004.

Business Telecom Users Benefit from UNE-P Based Competition, (with Lee L. Selwyn) prepared on behalf of AT&T, January 2003.

Inflated BOC Prices: An Agenda for State PUC Action Arising from the FCC CPR Audits, (with Lee L. Selwyn) prepared on behalf of AT&T, July 2000.

The "Connecticut Experience" with Telecommunications Competition: A Case Study in Getting it Wrong, (with Lee L. Selwyn and Helen E. Golding) prepared on behalf of AT&T, February 1998.

Commercially Feasible Resale of Local Telecommunications Services: An Essential Step in the Transition to Effective Local Competition, (with Lee L. Selwyn) prepared on behalf of AT&T, July 1995.

*The Enduring Local Bottleneck: Monopoly Power and the Local Exchange Carriers,*prepared by Economics and Technology, Inc. (with Lee L. Selwyn) and Hatfield Associates, Inc., on behalf of AT&T, MCI Communications Corporation, Competitive Telecommunications Association, February 1994.

LEC Price Cap Regulation: Fixing the Problems and Fulfilling the Promise , (with Lee L. Selwyn, David J. Roddy, Sonia N. Jorge and Scott C. Lundquist), prepared on behalf of the Ad Hoc Telecommunications Users Committee, May 1994.

Access and Competition: the Vital Link, (with Lee L. Selwyn), prepared on behalf of the Ad Hoc Telecommunications Users Committee, April 1994.

Pricing and Policy Issues Affecting Local/Access Service in the U.S. Telecommunications Industry, (with Lee L. Selwyn, W. Page Montgomery, and Jenny H. Yan), prepared on behalf of the Canadian Radio-Television and Telecommunications Commission, December 1992. *ISDN Has Come of Age*, (with Lee L. Selwyn), prepared on behalf of Prodigy Services Company, November 1992.

A Roadmap to the Information Age: Defining a Rational Telecommunications Plan for Connecticut, (with Lee L. Selwyn, Susan M. Baldwin, JoAnn S. Hanson, David N. Townsend and Scott C. Lundquist), prepared on behalf of the Connecticut Office of Consumer Counsel, October 30, 1992.

Migration Plan for Residential ISDN Deployment, (with Lee L. Selwyn) prepared on behalf of the Communications Policy Forum, Electronic Frontier Foundation, April 20, 1992.

Efficient Pricing for ONA Access : Recommendations for Modifications to Part 69 of the FCC's Rules to Accommodate an Open Network Architecture, (with Lee L. Selwyn, JoAnn S. Hanson, and David N. Townsend), prepared on behalf of the Coalition of Open Network Architecture Parties, The ONA Users Group, and Ad Hoc Telecommunications Users Committee, August 10, 1989.

Use of Featured Group Carrier Switched Access Services for National Paging Access: An Examination of Potential Feasibility, (with Lee L. Selwyn) prepared on behalf of National Satellite Paging, Inc., March 15, 1989.